

ANALYSIS OF AMENDED BILL

Author: Campbell/Runner Analyst: Rachel Coco Bill Number: SB 14
 Related Bills: See Legislative History Telephone: 845-4328 Amended Date: February 2, 2005
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT:	Underpayment of Estimated Tax Penalty Relief
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SUMMARY

This bill would provide an exception to the estimated tax underpayment penalty.

SUMMARY OF AMENDMENTS

The February 2, 2005, amendments removed language relating to the personal property tax exemption on aircraft and replaced it with language to provide relief from the underpayment of estimated tax penalty.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

According to the authors' office, the purpose of this bill is to protect taxpayers from underpayment of estimated tax penalties incurred through no fault of their own.

EFFECTIVE/OPERATIVE DATE

As an urgency statute, this bill would be effective immediately upon enactment. This bill would apply to penalties for underpayments resulting from the suspension of the Teacher Retention Credit for taxable year 2004 and to penalties for underpayments caused or increased by tax law changes imposed on and after January 1, 2006.

POSITION

Support.

On December 1, 2004, the Franchise Tax Board voted 2-0 to sponsor the provisions of this bill.

Board Position:

<u> X </u> S	<u> </u> NA	<u> </u> NP
<u> </u> SA	<u> </u> O	<u> </u> NAR
<u> </u> N	<u> </u> OUA	<u> </u> PENDING

Department Director

Date

Gerald H. Goldberg

2/25/05

ANALYSIS

FEDERAL/STATE LAW

Under current state and federal laws, taxpayers generally are subject to a penalty for any underpayment of estimated tax. The penalty is an amount equal to the underpayment rate¹ multiplied by the amount of the underpayment.

State and federal laws have allowed exceptions to the estimated tax underpayment penalty when the underpayment resulted from a specified legislative change.

Under California law, a statute that changes the imposition of tax is immediately effective and operative for taxable years beginning on the preceding January 1st. Current state law allows a tax credit, known as the Teacher Retention Credit, for teachers based upon the taxpayer's years of service as a credentialed teacher.

Recently enacted legislation (SB 1100, Stats. 2004, Ch. 226) suspended the Teacher Retention Credit for the 2004 and 2005 taxable years.

THIS BILL

This bill would provide an exception to the estimated tax underpayment penalty that results when a law change retroactively increases a taxpayer's estimated tax payment. This exception would apply to penalties imposed on and after January 1, 2006. Since the bill specifies that the exception would apply to law changes chaptered during the taxable year of the underpayment, it would not apply to federal law changes that may create an underpayment of state tax because federal law is enacted without being chaptered.

This bill would provide a specific exception to the estimated tax underpayment penalty for individuals who underpaid their estimated taxes during the 2004 taxable year due to the suspension of the Teacher Retention Credit.

This bill also would repeal several obsolete provisions containing specific exceptions to the estimated tax underpayment penalty for taxable years prior to 2003.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not impact the department's programs or operations.

¹ The underpayment rate is the sum of the Federal short-term rate, as determined by the Secretary, and three percentage points.

LEGISLATIVE HISTORY

SB 1100 (Senate Committee on Budget and Fiscal Review, Stats. 2004, Ch. 226), among other things, suspended the Teacher Retention Credit for the 2004 and 2005 taxable years.

AB 1122 (Corbett, Stats. 2002, Ch. 35), among other things, conformed state law to the federal law requiring 90% of the current year tax liability to be paid as estimated tax payments.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. Research showed that these states have similar provisions to California's existing underpayment of estimated tax penalty provisions and allow exceptions to the penalty in specified instances.

FISCAL IMPACT

This bill would not impact the department's costs.

ECONOMIC IMPACT

While this bill would not directly impact state income tax revenue, a permanent exception would apply to any future change in state law that is intended to increase revenue in the year of enactment and could eliminate the incentive to increase estimated tax payments for the current taxable year. As a result, there may be a delay in the receipt of revenue from the new law: instead of immediate acceleration due to changes in withholding, revenue would be realized at the next return filing date. If there were a need to accelerate revenue in the taxable year of a future law change, language could simply be added to expressly prohibit application of the penalty exception for that law change.

ARGUMENTS/POLICY CONCERNS

This bill would repeal Section 19136.5 of the Revenue and Taxation Code, which provides an exception to the underpayment of estimated tax penalty where the underpayment was a direct result of a law change in another state. Department staff recommends that this provision in current law be allowed to remain since this bill does not address law changes in other states.

LEGISLATIVE STAFF CONTACT

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